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Decision 02-04-050 April 22, 2002

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion Into Competition for Local Exchange Service.	Rulemaking 95-04-043 (Filed April 26, 1995)
Order Instituting Investigation on the Commission's Own Motion Into Competition for Local Exchange Service.	Investigation 95-04-044 (Filed April 26, 1995)

OPINION DENYING MOTION OF ROSEVILLE TELEPHONE COMPANY

Summary

On May 1, 2001, Roseville Telephone Company (Roseville) filed a motion for an order requiring all competitive local exchange carriers (CLECs) to provide security for the difference between the unbundled network element (UNE) rates adopted by the Commission in Decision (D.) 00-06-080 and the interim UNE prices allegedly based on a proxy and subject to true up in D.01-02-042. Roseville claims that such security is needed to protect itself and its customers from the risk that a CLEC may not be financially able to pay the final UNE prices once the true up occurs. We hereby deny Roseville's motion for reasons set forth below.

Background

As a basis for its motion, Roseville makes reference to D.00-06-080. In this decision, the Commission affirmed the results adopted in the Final Arbitrator's

Report relating to Application 00-01-012, the arbitration of the interconnection agreement between Covad Communications Company (Covad) and Roseville.

In D.00-06-080, the Commission adopted Roseville's proposed prices for UNEs. Covad sought rehearing to challenge the Commission's decision on UNE's. While rehearing was pending, Roseville entered into interconnection agreements with other CLECs which adopted the UNE rates in the Covad arbitration.

In D.01-02-042, the Commission granted rehearing, and set temporary UNE prices based on Pacific Bell's (Pacific) UNE rates which will be subject to true up after further proceedings to determine final UNE prices for Roseville. For the reasons discussed in and found persuasive by the Commission in D.00-06-080, Roseville believes its final UNE prices will probably be higher than Pacific's. Accordingly, Roseville anticipates that CLECs will owe Roseville the difference between the interim UNE rates adopted in D.01-02-042 and the final UNE rates which have yet to be established.

Roseville claims that it has a legitimate interest in ensuring the payment of the amounts it will be owed if the final UNE rates adopted by the Commission are higher than the interim rates adopted in the order granting rehearing. Accordingly, Roseville wants assurance from any party to an interconnection agreement seeking UNEs at the temporary rates adopted in the order granting rehearing that it has the financial ability to pay the amounts ordered as part of a future true-up when Roseville's final UNE rates are established.

Roseville, therefore seeks an order requiring a security deposit in an amount equal to the difference between the interim UNE rates adopted in the order on rehearing and the rates adopted in D.00-06-080 during the period that the Commission is considering Roseville's final UNE rates. As an alternative,

Roseville proposes that the CLECs could be required to post a bond, letter of credit, guarantee, or other security found reasonably acceptable to protect Roseville and its subscribers.

Absent these security provisions, Roseville claims it will be at risk for substantial sums of money that might be lost if CLECs that have obtained UNEs at the interim rates adopted in the order granting rehearing are unable to pay the amount due when these rates are trued-up to Roseville's final UNE rates.

A response in opposition to Roseville's motion was jointly filed by Z-Tel Communications, Inc., WorldCom, Inc., Sprint Communications L.P., and Rhythms Links, Inc. (Joint Parties). The Joint Parties oppose the motion, arguing that the requirements that Roseville seeks to impose should have been negotiated or arbitrated a year ago, prior to the Commission's approval of the Roseville/Covad interconnection agreement. Under Section 252(b)(4)(A) of the Telecommunications Act of 1996 (the "1996 Act") and Rule 3.10 of Resolution ALJ-181, the issues that may be decided by the Commission in arbitrating an interconnection agreement are limited to those raised in the petition for arbitration and the response thereto, both of which were filed long ago.

Accordingly, the Joint Parties argue that any right that Roseville may have to re-open negotiations with CLECs regarding the terms for obtaining UNEs or other provisions depends solely on the language of the parties' approved interconnection agreements, but that Roseville does not have the right to seek unilateral modifications to approved interconnection agreements merely by filing generic motions with the Commission.

Moreover, the Joint Parties argue that it would be impossible to set an appropriate deposit level because there is no way to know what Roseville's

permanent prices will be. The Joint Parties further claim that deposit requirements should never apply to customers, including CLECs, with good payment histories.

Roseville filed a third-round reply on May 29, 2001, taking exception to the arguments of the Joint Parties, and contending that its motion does not violate the rules governing negotiation and arbitration of interconnection agreements. Roseville argues that its proposal is workable and necessary given the questionable financial status of CLECs.

On November 2, 2001, the assigned ALJ issued a ruling calling for additional information from Roseville relating to the specific interconnection agreements, and the level of security that would be required from each CLEC with which it has an interconnection agreement. Roseville filed a response in compliance with the ALJ ruling on November 21, 2001, providing the information set forth in the ruling.

Discussion

Roseville has raised a concern regarding the potential risk that Covad, as well as other CLECs that are not creditworthy, may not be financially able to pay the UNE rates that may ultimately be adopted. If final UNE rates turn out to be higher than the current interim rates, certain CLECs with limited or no surplus cash reserves may find it difficult to pay Roseville for any shortfall relating to past underpayments.

We appreciate that Roseville did not anticipate the specific risk of collecting the difference between the interim and final UNE rates at the time that it negotiated the Covad interconnection agreement. During the time Roseville negotiated the Covad interconnection agreement, however, it could not reasonably have foreseen that the Commission would grant rehearing of UNE

rates in D.01-02-042. In D.01-02-042, the Commission also adopted Pacific's lower UNE prices, as approved in D.99-11-050, as the proxy for Roseville's interim UNE prices, subject to true-up, with interest, upon the approval of final prices. It was this subsequent act of the Commission, therefore, that created the uncertainty as to what level of UNE rates would ultimately be required of the CLECs. Roseville is concerned that Covad, or other CLECs, may not have sufficient funds to pay any increased UNE charges attributable to the true up once final rates are determined. Roseville raises the concern that CLECs are not credit worthy risks, and provides anecdotal evidence of the financial problems facing at least some CLECs.

We have no reason to doubt that at least some CLECs with which Roseville has interconnection agreements may be facing financial difficulties. No other party presented any evidence contradicting the indications of financial difficulties facing various CLECs. The preexisting financial problems of various CLECs thus imposed increased risk on Roseville after the issuance of D.01-02-042. This increased risk resulted from the uncertainty created by D.01-02-042 as to what UNE charges would ultimately be due and payable to Roseville, and whether CLECs would have sufficient funds to remit any back payments that may become due once a final UNE rate order was issued. Consequently, Roseville could not be reasonably expected to negotiate a security provision in its interconnection agreements related to a subsequent risk that was created by action of the Commission.

We recognize that the issues that may be decided by the Commission in arbitrating interconnection agreements are limited to those raised in the petition for arbitration. Yet, the relief requested by Roseville does not involve relitigating the arbitration of any interconnection agreement. The Commission has ongoing

authority within this rulemaking proceeding to adopt or modify rules governing local competition that are in the public interest. Nonetheless, although we have authority to adopt or modify local competition rules, we find no basis to impose additional security deposits on CLECs in the manner proposed by Roseville.

We acknowledge Roseville's general concerns as to the creditworthiness of certain CLECs that would purchase UNEs from Roseville, and the heightened risk of their incapacity to make up any past underpayments. Roseville's risk of underpayment of UNE prices must however be weighed against the risk that CLECs would face by tying up excessive funds for an indefinite period in the event that final UNE prices prove to be less than interim prices.

Assuming a requirement for financial security in excess of existing UNE prices was otherwise justified, moreover, there must be a reasonable basis upon which to quantify such incremental amounts. Roseville proposes basing security requirements upon the difference between UNE prices adopted in D.00-06-080 versus D.01-02-042. Yet, we find no sound basis to use the UNE prices adopted in D.00-06-080 for determining the amounts of any security, given our findings in D.01-06-089 that such prices are contrary to law, as discussed below.

Moreover, we find no basis to support Roseville's claim that it is "probable" that final UNE prices would be higher than the interim prices that the Commission set in D.01-02-042. As support for such claim, Roseville refers to "the reasons discussed in and found persuasive by the Commission in D. 00-06-080." Yet, whatever aspects of Roseville's cost study may have appeared "persuasive" in D.00-06-080 have since been nullified based on the Commission's further findings in D.01-02-042 and D.01-06-089.

First in D.01-02-042, the Commission rescinded the UNE prices set in D.00-06-080 and granted rehearing of Roseville's cost study. We found that the most reasonable proxies to adopt for Roseville on an interim basis were Pacific's UNE prices. In D.01-06-089, the Commission subsequently denied Roseville's application for rehearing of D.01-02-042. In D.01-06-089, we denied Roseville's request to reinstate its UNE prices, originally adopted in D.00-06-080, while the rehearing proceeded. In that same decision, the Commission reversed its opinion of the validity of Roseville's cost study presented in D.00-06-080, and expressly found that Roseville's cost study violated "[f]undamental requirements of the Telecom Act, FCC regulations, and Commission [r]ules…"

In D.01-06-089, we thus concluded that the prices derived from Roseville's cost study are not acceptable, even on an interim basis, since they are based on a pricing concept very different from the incremental principles set forth in the 1996 Telecommunications Act, FCC regulations, and our rules. Yet, Roseville would essentially seek a similar result through its proposal for a security deposit that we have already rejected in D.01-06-089. Whether a CLEC is paying Roseville's UNE prices directly, or indirectly in the form of a security deposit, the CLEC would still be tying up the use of those funds for the duration of the rehearing.

For the same reasons we declined to use Roseville's UNE rates as a basis for interim charges during the pendancy of the rehearing, we likewise decline to compel CLECs to encumber funds based on those invalidated rates in the form a security requirement. It would be inconsistent with D.01-06-089 to impose security requirements on CLECs on an interim basis that are based on that same cost study that we have already found to be unacceptable.

For similar reasons, we likewise find no "probability" that Roseville's final UNE rates will necessarily be higher than interim rates. While there may be some possibility that final UNE rates could be higher than interim rates, they may instead be lower. It would simply be speculation to assume final UNE prices will be higher than interim prices by some fixed amount. In any event, there would be no basis to rely on the interim prices from D.00-06-080 for computing the size of any security requirements to be imposed.

We recognize that there is no assurance that Roseville will necessarily collect underpayments from financially troubled CLECs if final rates turn out to be higher. In D.01-06-089, we addressed this concern in the context of Roseville's collection of payment from Covad. As noted in D.01-06-089, Roseville complained that it could not be assured of payment by Covad pursuant to the true-up if the final local loop price proved to be higher than the interim price. In that rehearing proceeding, the record did not show Covad's financial condition. (Application for Rehearing, at 11.) As noted in D.01-06-089, we could not, therefore, guarantee Covad's financial condition or its ability to pay should there be an amount due Roseville. We also could not guarantee Roseville's voluntary, prompt payment to Covad should the final local loop price turn out to be lower than the interim price.

Moreover, in D.01-06-089, we modified the earlier language from D.01-02-042 that had stated"…the provision for a true-up of the interim prices, with interest, *assures* Roseville that it will be appropriately compensated when its cost study is completed and final UNE prices are approved." (D.01-02-042, at 11, emphasis added.) In D.01-06-089, we removed the word "assures" and modified the statement to read: "…the provision for a true-up of the interim prices, with interest, *provides* for Roseville to be appropriately compensated if upon the completion and

acceptance of Roseville's TELRIC cost study, final UNE prices are higher than the interim prices." (*id.*, emphasis added).

Thus, the modified language as adopted in D.01-06-089 clarified the Commission's view that the true up mechanism enabled Roseville to be appropriately compensated for any potential underpayments. At the same time, the Commission deleted language from the decision that could imply that Roseville is somehow entitled to a 100% guarantee that CLECs will ultimately pay all that is owing.

Accordingly, in view of the uncertainties involved, we find no basis to determine specific security requirements to impose on CLECs, or to encumber CLEC funds beyond those required to pay Roseville the interim UNE charges as found reasonable in D.01-02-042. On this basis, we shall deny Roseville's motion.

Comments on Draft Decision

The draft decision of Administrative Law Judge Thomas R. Pulsifer in this matter was mailed to the parties in accordance with Section 311(g) and Rule 77.7 of the Rules of Practice and Procedure. Comments were filed on March 25, 2002, and reply comments were filed on April 2, 2002. In addition to Roseville, comments were filed by XO California, Inc. We have taken comments into account in finalizing this order.

Findings of Fact

1. Roseville entered into a number of interconnection agreements with CLECs which incorporated UNE rates equivalent to those adopted in D.00-06-080, regarding its arbitration with Covad.

2. In D.01-02-042, the Commission granted rehearing of D.00-06-080, and set lower interim UNE prices for Roseville based on Pacific Bell's UNE rates, with provision for a true-up once final UNE prices are determined for Roseville.

3. Roseville is concerned that if its final UNE prices prove higher than its interim prices, at least some CLECs may have financial difficulty reimbursing Roseville for the balance due for past UNE purchases once the true-up amount is determined.

4. Anecdotal evidence of the financial problems facing at least some CLECs, established that such financially troubled CLECs could face cash flow difficulties in making up past UNE underpayments.

5. The issue of security deposits for underpayment of UNE prices was not previously raised as an issue by Roseville in its arbitration proceedings.

6. At the time Roseville negotiated or abitrated interconnection agreements subject to UNE rates in effect prior to February 2001, it could not reasonably have foreseen that the Commission would grant rehearing of UNE rates in D.01-02-042, and create a new risk of underpayment of UNE charges.

7. Since rehearing was granted on the appropriate level of Roseville's UNE rates, there is uncertainty as to the level of final UNE rates.

8. In D.01-02-042, the Commission found that the most reasonable UNE proxies to adopt for Roseville on an interim basis were Pacific Bell's UNE prices.

9. Roseville is currently being compensated for provision of its UNEs to CLECs based on the interim prices adopted in D.01-02-042.

10. In D.01-06-089, the Commission reversed its opinion of the validity of Roseville's cost study presented in D.00-06-080, and expressly found that Roseville's cost study violated fundamental requirements of the Telecommunications Act, FCC regulations, and Commission rules.

11. Given the Commission's reversal of opinion in D.01-06-089, the basis has been removed for reliance on the UNE prices in D.00-06-080 for purposes of determining a CLEC security requirement, as Roseville proposes.

12. Consistent with D.01-06-089 the adopted true up mechanism reasonably provides for Roseville to be compensated for future potential underpayment of UNE charges by CLECs, even though it does not guarantee payment of all potential underpayments, particularly by financially troubled CLECs.

13. Roseville's risk of potential underpayment of UNE charges is counterbalanced by the risk of CLECs tying up excessive funds for an indefinite period in the event that final UNE charges prove to be less than interim charges.

Conclusions of Law

1. Roseville has not provided a sufficient basis to justify imposing a generic financial security requirement on all CLECs with which Roseville has interconnection agreements.

2. It is reasonable to presume that a CLEC that does not have an investment grade rating from a major credit rating agency has an increased financial risk of default on its UNE payments to Roseville.

3. Under Section 252(b)(4)(A) of the Act and Rule 3.10 of Resolution ALJ 181, the issues that may be decided by the Commission in interconnection agreement arbitrations are limited to those raised in the petition for arbitration and the response thereto.

4. Roseville's motion does not violate rules against relitigating the arbitration of interconnection agreements, since the requested relief merely entails generic rulemaking in the Local Competition proceeding.

5. Independent of the arbitration process for any individual interconnection agreement, the Commission retains ongoing authority within this rulemaking proceeding to adopt or modify rules for local competition in the public interest.

6. Although Roseville did not negotiate a security provision in interconnection agreements related to a subsequent risk that was created by

action of the Commission, such risk was not reasonably foreseeable at the time Roseville negotiated or arbitrated interconnection agreements that predated D.01-02-042.

7. Although the Commission has authority to adopt or modify local competition rules, Roseville has failed to justify new rules imposing additional security requirements on CLECs for potential underpayment of final UNE charges.

8. It would be inconsistent with D.01-06-089 to impose security requirements on CLECs that are based on the same cost study that was found to be unacceptable pursuant to that decision.

9. It would be mere speculation to assume final UNE prices will necessarily be higher than interim prices by some fixed amount.

10. Roseville's motion for imposing additional security requirements on CLECs has not been justified and should be denied.

O R D E R

IT IS ORDERED that the motion of Roseville Telephone Company for an order requiring security establishment of an acceptable form of a competitive local exchange carriers to mitigate the risk of potential underpayment of final unbundled network element prices is denied.

This order is effective today.

Dated April 22, 2002, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
CARL W. WOOD
GEOFFREY F. BROWN
MICHAEL R. PEEVEY
Commissioners